Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	**CC Docket No. 96-262**
	)	
Price Cap Performance Review for Local Exchange Carriers	)	**CC Docket No. 94-1**
	)	
	)	
Transport Rate Structure and Pricing	)	**CC Docket No. 91-213**
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	**CC Docket No. 96-263**

INITIAL COMMENTS OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS, CONSUMER FEDERATION OF AMERICA, AND CONSUMERS UNION

January 29, 1997

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EXECUTIVE SUMMARY

The American Association of Retired Persons, the Consumer Federation of America and the Consumers Union asks the Federal Communications Commission to act immediately to ensure that customers receive lower telephone rates as a result of the Telecommunications Act of 1996. The FCC should lower the $3.50 subscriber line charge that all consumers pay; reduce the access charges that long-distance companies pay, and mandate that these reductions be passed directly through to consumers.

The Commission's desire to introduce market forces into the pricing of network access is laudable. It is unrealistic, however, to believe that efficient prices will be accomplished without immediate, prescriptive steps to eliminate the anti-competitive and inefficient pricing of access. If the Commission leaves to market forces the imposition of efficient access prices, it is likely that the incumbent ILECs will continue to earn billions of dollars in excess profits and recover billions of dollars of inefficient investment. Market forces are not adequate today to impose market discipline on incumbent ILECs.

The Commission has already rejected ILEC claims to illegitimate costs with the adoption of Total Element Long Run Incremental Cost (TELRIC) pricing in the Local Competition Order. In addition, the Federal-State Joint-Board on Universal Service has recommended the use of TELRIC pricing in the Universal Service Proceeding. To fail to adopt the same standard on the issue of access charge reform would be inconsistent and seriously damage the prospects for competition in the local telephone market.

As long as access charges are above TELRIC, ILECs retain a competitive advantage for entry into in-region long distance. In today's marketplace, inflated access pricing has a serious anti-competitive effect. Price squeeze is inevitable if access is priced above TELRIC, since by definition ILECs will be charging more than it costs them to provide the service.

Our organizations believe that the gap between embedded and forward-looking, efficient costs is made up of excess profits, inefficiencies and strategic investments. The ILECs do not have a legitimate claim to these costs. Further, the industry cannot be effectively reformed if ILECs are allowed to continue to impose these costs on potential competitors in the form of inflated access charges. The Commission should therefore move toward pricing at efficient, forward-looking levels as quickly as possible.

In anticipation of expanded competition in telecommunications networks, we suggest that there are three fundamental legal and economic reasons to support the rejection of these costs: the claimed costs are overstated, the recovery of all network costs from only basic service is excessive and inappropriate, and the recovery of these costs from basic service ratepayers would be anti-competitive.

The gap between embedded costs and forward looking costs is made up of a variety of items that consumers should not be obligated to pay under any form of

regulation -- and would never be forced to pay in a competitive marketplace. Part of this gap includes costs claimed by the ILECs that should not be recovered because they represent excess profits and inefficiencies in operation. Another part of the costs claimed by the ILECs should not be recovered from basic service rates because they were incurred as investments to support other, competitive services. If the ILECs are the most efficient providers of these services, they will recover these costs in the prices they charge in the competitive marketplace for the services supported by those facilities. Lastly, another part of these costs has already been compensated through the extremely high risk premiums earned by the RBOCs and their failure to write off any assets on their regulatory books.

The ILECs base their claim that they are entitled to recovery of stranded costs on a version of the "regulatory compact" that they insist has existed during their tenure as monopoly providers of local telephone service. In fact, this version of the "regulatory compact" between stockholders and ratepayers never existed. The ILECs' guarantee of recovery claim is an *ex post facto* effort to recover assets and recoup losses from actions for which management bears responsibility and stockholders have already been handsomely compensated.

Based upon these fundamental observations, we believe that the Commission should immediately reform access charges and ensure that residential ratepayers receive the benefits of these cost reductions. We recommend that the Commission reduce access charges from their current level of $23.4 billion to $15.6 billion. **See Table 1 in Comments.**

Driving costs to TELRIC and recognizing the loop as a common facility used to provide all services should result in a reduction in the subscriber line charge of over 50 percent. Similarly, driving local switching costs to the forward-looking, efficient levels should result in a reduction of those costs of over 50 percent.

One of the central tenets of telecommunications public policy is that the loop is a cost shared among all of the telecommunications services that utilize it: local and long distance, basic and enhanced, information, data, and video.

First, all services that utilize the telecommunications network should pay for all facilities that they use in reasonable proportion to the nature of the demand that they place on it. This is a simple and sound economic principle.

Second, the quantity and type of demands placed on facilities by services should be reflected in the costs that they are responsible for recovering. The more a service uses and the higher the level of functionality a service requires of a facility, the greater the responsibility it should bear for recovering its costs.

Third, it is now clear that loop costs are falling dramatically. Furthermore, the introduction of digital technology to the loop has dramatically lowered the cost of providing loop and spread those costs over a much broader array of services. The Joint

Board recognized this principle when it recommended that universal service support from the high cost fund take into account all revenues earned in an exchange.

Since its establishment in the mid-1980s, the SLC has never been reduced to reflect the substantial decline in the cost of basic service that has occurred over this period. An analysis of the decline in loop costs since divestiture would suggest a reduction in the SLC on the order of 20 to 50 percent.

Our organizations believe that the share of loop costs allocated to the federal jurisdiction should remain at 25 percent of the loop. However, since loop costs should be calculated at TELRIC, the total amount recovered from the federal jurisdiction should be reduced. Based on the Commission's estimate of TELRIC loop costs in the local competition proceeding, we believe the combined amount should decline to approximately $3.60 per month.

This recommendation on changes in the recovery of loop costs makes it clear that we reject the Commission's suggestion that the SLC for second residential lines should be raised.

The Commission should continue to require long distance service providers to pay for the use of the loop, since it is a common cost subject to section 254 (k) of the 1996 Act. However, we are not opposed to carefully transforming the CCL into a channel charge placed on the provider of the service, since the channel is what is being used.

Switching costs should also move toward forward looking efficient costs. This requires elimination of the Transport Interconnection Charge (TIC).

All reductions in access charges should be passed through to basic service rates. The Commission should require that basic long distance service rates be lowered by the amount of the reduction to ensure that residential ratepayers receive the full benefit of the reduction. Recent pricing activity by the long distance companies makes it clear that simply lowering their access costs will not result in a pass-through to consumers.

The Commission repeatedly raises questions about the averaging of costs and dissecting costs to distinguish variable and fixed costs. We believe that it makes little sense to consider any averaging of costs to be a subsidy since it is quite clear that marketplace prices commonly vary in their relationship to costs. In fact, most costs are not incurred in the theoretically pure manner.

Although we have advocated a prescriptive approach to access charge reform, if the Commission is inclined to adopt a market-based approach, we believe the FCC must abandon its amorphous, non-specific approach to declaration of competitiveness. The FCC should require specific measures of competitiveness in specific product and geographic markets. "Potential" competition should be rejected as a standard of

competitiveness. Only "actual" competition should be considered sufficient. Markets should be defined by the actual availability of direct substitutes.

Tests of effective competition should include:

1. Consideration of the number and size of actively participating alternative providers.
2. The extent to which directly comparable services are available from alternative providers in relevant markets.
3. The ability of alternative providers to offer equivalent services at competitive prices.
4. The market share held by the telephone company.
5. Whether the telephone company is earning monopoly profits from the service or product.

Ultimately, effective competition means multiple suppliers for significant numbers of subscribers with significant numbers of subscribers having taken alternative service.

Finally, the Commission needs rules for reclassifying a service if it proves not to be competitive over time.

In conclusion, the American Association of Retired Persons, the Consumer Federation of America, and the Consumers Union ask the Commission to prescribe a reduction of the Subscriber Line Charge and the access charges that long distance companies pay to the RBOCs. Moreover, we ask the Commission to mandate the pass through of access charge reductions in the basic long distance rates that companies charge. This approach is consistent with the Joint Board's Recommended Decision in its universal service proceeding and the Commission's ruling in the local competition proceeding. Most importantly, this approach will guarantee consumers immediate reductions in telephone rates and improve the chances for competition in the local telephone market.

I. INTRODUCTION

A. THE COMMENTING ORGANIZATIONS

The American Association of Retired Persons, the Consumer Federation of America and Consumers Union,[1] respectfully submit these initial comments in this response to the Notice of Proposed Rulemaking.[2]

B. ORGANIZATION OF THE COMMENTS

These comments are organized as follows.

Section II presents the answers to the two most fundamental public policy questions underlying the issue of access charge reform:

What should happen to the gap between embedded cost and efficient costs?

How should access charge reform be effectuated -- through prescription of rates or pricing flexibility afforded to the incumbent local exchange companies (ILECs)?

Section III makes recommendations on the recovery of loop costs that have been allocated to the federal jurisdiction. The recommendations pertain to both the costs currently recovered from subscribers through the Subscriber Line

[1] See Attachment 2 for a description of the commentors.

[2] Federal Communications Commission, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, In the Matter of Access Charge Reform, Price Cap Performance Review of Local Exchange Carriers, Transport Rate Structure and Pricing, and Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket Nos. 96262, 94-1, 91-213, 96-263, December 23, 1996 (hereafter, Access Charge Notice).

Charge (SLC) and the costs currently charged to long distance companies (Interexchange Carriers, IXCs) in the form of the Carrier Common Line Charge (CCLC).

Section IV examines the recovery of local switching costs.

Section V presents responses to specific questions raised by the Commission with respect to some of the administrative and legal issues in access charge reform.

II. THE FUNDAMENTAL PRINCIPLES TO GOVERN ACCESS CHARGE REFORM

The core question in access charge reform can be simply stated:[3] How should the gap between forward-looking, efficient costs and the embedded costs claimed by the ILECs be defined and treated in the course of access charge reform?

If one concludes that the gap is made up of costs which ILECs should recover (but cannot or should not recover through artificially high access charges), one must design alternative regulatory mechanisms to replace these revenues.

[3] Although the FCC states this question late in the notice (Chapter VII), it is the driving force behind access charge reform if efficiency is the objective because the entirety of the gap between current and efficient prices can be eliminated by proper treatment of this issue.

If, on the other hand, one concludes that the ILECs do not have a legitimate claim to these costs, access charges can be rationalized and ILECs can either write the costs off or attempt to recover them in a competitive marketplace.

A. ACCESS CHARGES CURRENTLY INCLUDE VASTLY OVERSTATED COSTS WHICH SHOULD NOT BE RECOVERED FROM NETWORK ACCESS SERVICE

Our organizations believe that the gap between embedded and forward-looking, efficient costs is made up of excess profits, inefficiencies and strategic investments. The ILECs do not have a legitimate claim to these costs. Further, the industry cannot be effectively reformed if ILECs are allowed to continue to impose these costs on potential competitors in the form of inflated access charges. The Commission should therefore move toward pricing at efficient, forward-looking levels as quickly as possible.

We base this conclusion on a long series of joint and separate analyses and testimony presented by the American Association of Retired Persons and the Consumer Federation of America,[4] as well as the recently concluded analysis contained in **Attachment 1**.

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[4] Joint papers dealing with these issues include Expanding the Information Age for the 19902: A Pragmatic Consumer View (1990); "Promoting Competition and Ensuring Consumer Protection on the Information Superhighway: Testimony of Dr. Mark N. Cooper on Behalf of the American Association of Retired Persons and the Consumer Federation of America on Proposed Revisions of Chapter 364," Florida House of Representatives, March 22, 1995; "Initial Comments of the American Association of Retired Persons, the Consumer Federation of America, and Consumers Union," In the Matter of Federal-State Joint Board on Universal Service , CC Docket No. 96-45, April 12, 1996 (hereafter Joint Comments), "Reply Comments of the American Association of Retired Persons, the Consumer Federation of America, and Consumers Union," In the Matter of Federal-State Joint Board on Universal Service , CC Docket No. 96-45, May 7, 1996 (hereafter Joint Comments). AARP papers include, David Gabel, The Impact of Premium Telephone

First, the costs claimed by the ILECs are vastly overstated. Rigorous cost analysis reveals that these costs are not consistent with the costs that an efficient provider of local telephone service would incur.[5] A policy that institutionalizes these claimed costs in basic rates would provide these companies with an unfair windfall of economic resources. Moreover, such a policy would effectively reward them for strategic investments intended to give them a competitive advantage.

Second, the recovery of all network costs from only basic services is excessive and inappropriate. Under the new federal law, local exchange companies will be allowed to utilize the same facilities that are used for local service to deliver a number of new services, including interlata long distance and video services.[6] While the ILECs claim that they are not generating adequate revenues from the provision of basic service, the companies will generate new sources of revenue from new services that use the same network facilities. We believe that all services which use the network should pay for all of the facilities they use.

Because the same facilities used to provide basic local service will be used to provide new services, regulators should not only look at the downside of

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Services on the Technical Design, Operation and Cost of Local Exchange Plant (State Legislation, American Association of Retired Persons, 1992) (hereafter The Impact) and David Gable, Current Issues in the Pricing of Voice Telephone Services, (American Association of Retired Persons, 1995) (hereafter, Current Issues.), as well as interventions in individual states, such as Indiana and Ohio. CFA papers include Excess Profits and the Impact of Competition on the Baby Bells, Consumer Federation of America, September 1996 (hereafter, Excess Profits).

[5] Current Issues

[6] "Direct Testimony of Dr. Mark N. Cooper on Behalf of New York Citizens Utility Board, The Consumer Federation of America, the American Association of Retired Persons, Consumers Union and Citizens Action of New York," Petition of the New York Citizens Utility Boars, the Consumer Federation of America, the American Association of Retired Persons, Consumers Union, Mr. Mark Green, Ms. Catherine Abate, the Long Island Consumer Energy Project and the International Brotherhood of Electrical Workers I-6 Council (Collectively the "Consumer Coalition") for an Investigation of the Proposed Merger of NYNEX Corporation and Bell Atlantic Corporation, Case 96-C-0599, December 16, 1996.

competition for the ILECs, but at the upside of revenue opportunities. Even if, due to competition, local exchange companies lose some local exchange and network access market opportunities to recover their joint and common costs in local markets, they will have gained many opportunities in other markets.

In essence, the gap between embedded costs and forward looking costs is made up of a variety of items that consumers should not be obligated to pay under any form of regulation -- and would never be forced to pay in a competitive marketplace. The first part of this gap includes costs claimed by the ILECs that should not be recovered because they represent excess profits and inefficiencies in operation.[7] The second part of the costs claimed by the ILECS were incurred as investments to support other, competitive services.[8] ILECs should not be allowed to recover these costs from basic service rates either. If the ILECs are the most efficient providers of these services, they will recover these costs in the prices they charge in the competitive marketplace for the services supported by those facilities. The last part of these claimed costs has already been compensated through the extremely high risk premiums earned by the RBOCs and their failure to write off any assets on their regulatory books. Recovery of these costs from basic local service rates should not be allowed.

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[7] Excess Profits

[8] Testimony of Harold L. Rees, Public's Exhibit No. 3," p. 44, both in State of Indiana, Indiana Utility Regulatory Commission, In the Matter of a Petition of Indiana Bell Telephone and Telegraph Company, Incorporated, for the Commission to Decline to Exercise in Part its Jurisdiction over Petitioner's Provision of Basic Local Exchange Service, to Utilize Alternative Regulatory Procedures for Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, and to Decline to Exercise in Whole its Jurisdiction Over All Other Telecommunications Services and Equipment Pursuant to IC 8-1-2-6, Cause No. 39075. Lee Selwyn, Analysis of Incumbent LEC Embedded Investment (ETI, May 1996).

B. THE ILECS HAVE NO LEGAL CLAIM TO THESE COSTS

The ILECs base their claim that they are entitled to recovery of stranded costs on a version of the "regulatory compact" that they insist has existed during their tenure as monopoly providers of local telephone service. In fact, this version of the "regulatory compact" between stockholders and ratepayers never existed.[9] The ILECs' guarantee of recovery claim is an *ex post facto* effort to recover assets and recoup losses from actions for which management bears responsibility and stockholders have already been handsomely compensated.

To compensate companies for uneconomic investments, when they have already been compensated for the risk of those investments, constitutes a double recovery of costs which violates the fundamental principles of just and reasonable rates. Far from guaranteeing this complete recovery of all costs rendered uneconomic by competition, current law places the burden of the risk of competition squarely on the shoulders of utilities. It shields them, at best, only from the most dire financial outcome -- bankruptcy.[10] In the case of the local exchange companies, their extremely strong financial position undermines any claims that failure to recover obsolete and uneconomic investment will threaten their financial soundness.

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[9] "Brief for Petitioners Regional Bell Operating Companies and GTE," in Iowa Utilities Board, pp. 69-73.

[10] Joint Brief of the National Association of Consumer Advocates and the Consumer Federation of America, Iowa Utilities Board v. Federal Communications Commission, December 16, 1996.

The RBOCs state that there is only a reallocation of risk in their interconnection comments. [11] This position seems to imply that there is not an unconstitutional taking under the FCC pricing scheme. The assertion that the pricing scheme contemplated by the FCC would take their property rests on the claim that they would not be able to alter their prices for non-core services in the marketplace to recover those costs. In fact, this is not the case because to the extent that they are more efficient or more effective competitors, ILECs will retain customers and revenue. In essence, the new law not only lays the foundation for potential competitors to take away customers from the ILECs, but also allows the ILECs to take away customers from others, such as the long-distance and cable companies. This "exchange of customers" is the vision of the law and negates the ILECs' taking argument.

C. THE COMMISSION MUST LOWER RATES BY REGULATION IF IT IS TO ACCOMPLISH ACCESS CHARGE REFORM

The Commission's desire to introduce market forces into the pricing of network access is laudable.[12] It is unrealistic, however, to believe that efficient prices will be accomplished without immediate, prescriptive steps to eliminate the anti-competitive and inefficient pricing of access. The ILECs continue to have a

[11] "Comments of SBC," Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC docket No. 96-98, p. 91; "Comments of Ameritech," Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC docket No. 96-98, p. 91 Ameritech clearly recognizes that its competitive entrants will have common costs, p.67; Comments of USTA," Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC docket No. 96-98.

[12] Notice, para. 14.

virtual monopoly on local exchange service (holding market share of over 99 percent)[13] and network access services (holding market share of over 98 percent).[14] The ILECs continue to challenge the legality of procompetitive policies at the federal[15] and state levels.[16] In addition, potential competitors have complained of inferior service[17] and discriminatory provisioning of the type of access necessary for the successful introduction of effective competition.[18]

If the Commission leaves to market forces the imposition of efficient access prices, it is likely that the incumbent ILECs will continue to earn billions of dollars in excess profits and recover billions of dollars of inefficient investment. Market forces are not adequate today to impose market discipline on incumbent ILECs. Allowing them to retain the excessive revenues from uneconomic pricing of network access will impede competition and add yet another barrier to the formidable obstacles already in place on the road to local competition.

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[13] The market share of competitors in Michigan, presumably the most highly developed market for local competition, since Ameritech has requested entry into in-region long distance, shows Ameritech with over 4.5 million access lines and competitors with about 40,000, a market share in excess of 99 percent. "Affidavit of Robert G. Harris and David J. Teece," In the Mater of Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region InterLATA Service in Michigan, pp. 29, 35 and Federal Communications Commission, Statistics of Common Carriers, 1996, Table 2.6

[14] Connecticut Research, "Local Telephone Competition 1995-6," 7th Annual, 1995.

[15] Iowa Utilities Board, et al. v. Federal Communications Commission, et al., in the United States Court of Appeals for the Eighth Circuit, No. 96-3321 (hereafter Iowa Utilities Board).

[16] See generally, GTE North, Inc. v. Quain, et al, Docket No. CV-196-2171(N.D.Pa.), Dec. 13, 1996.

[17] "AT&T's Reply Comments to Ameritech Michigan's December 16, 1996 Submission of Information Related to Compliance with the Competitive Checklist," Before the Michigan Public Service Commission, In the Matter, on the Commission's Own Motion, to Consider Ameritech Michigan's Compliance with the Competitive Checklist in Section 271 of the Telecommunications Act of 1996, Case No. U-11104.

[18] "Testimony of Dr. Mark N. Cooper on behalf of the Attorney General of the State of Oklahoma"

The Commission has already rejected ILEC claims to illegitimate costs with the adoption of Total Element Long Run Incremental Cost (TELRIC) pricing in the Local Competition Order.[19] In addition, the Federal-State Joint-Board on Universal Service has recommended the use of TELRIC pricing in the Universal Service Proceeding.[20] Thus, in the first two parts of the so-called trilogy of regulatory reform, federal policy makers have embraced the use of this pro-competitive pricing methodology. To fail to adopt the same standard on the issue of access charge reform would be inconsistent and seriously damage the prospects for competition in the local telephone market. By not using TELRIC in this proceeding, the Commission will have built a two-legged stool as the platform for launching effective competition.

D. ACCESS CHARGE REFORM MUST BE A PREREQUISITE FOR IN-REGION LONG DISTANCE ENTRY BY ILECS

As long as access charges are above TELRIC, ILECs retain a competitive advantage for entry into **in-region** long distance. In today's marketplace, inflated access pricing has a serious anti-competitive effect. Therefore, the requirement in the Act that the network be available on rates, terms and conditions that are just,

[19] First Report and Order, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, August 8, 1996 (hereafter, Local Competition Order). We take the Commission's definition of TELRIC to include joint and common costs.

[20] "Recommendation," In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, November 8, 1996 (hereafter, Universal Service).

reasonable and non-discriminatory cannot be met and entry into in-region long distance should not be allowed under these circumstances.

Price squeeze is inevitable if access is priced above TELRIC, since by definition ILECs will be charging more than it costs them to provide the service. Unbundled elements will only prevent discrimination if network access is offered as a separate unbundled element priced at its TELRIC. If network access is not offered as a separate element, then new entrants are forced to buy value added services they do not want or need to provide network access.

E. THE EVIDENTIARY BASIS FOR ACCESS CHARGE REFORM

Based upon these fundamental observations, we believe that the Commission should immediately reform access charges and ensure that residential ratepayers receive the benefits of cost reductions. We believe that the Commission has before it a substantial record on which to base the decision to reform access charges without delay. Based upon the Local Competition,[21] Universal Service,[22] Video Dialtone Cost Allocation,[23] and Price Cap proceedings,[24] we recommend that the Commission reduce access charges from their current level of $23.4 billion to $15.6 billion, as outlined in Table 1.

[21] Local Competition
[22] Universal Service
[23] In the Matter of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112.
[24] In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1.

TABLE 1: ELEMENTS OF ACCESS CHARGES, PRINCIPLES OF REFORM AND FUTURE LEVELS (in billions of dollars)

TYPE OF CHARGE	CURRENT LEVEL	BASIS FOR REFORM	REFORMED LEVEL
LOOP COSTS			
SUBSCRIBER LINE CHARGE (SLC)	7.1	TELRIC, COMMON COST ALLOCATION	3.2
CARRIER COMMON LINE CHARGE (CCLC)	3.7	TELRIC, COMMON COST ALLOCATION	3.2
SUBTOTAL	10.8		6.4
SWITCHING COSTS			
TRANSPORT INTERCONNECTION CHARGE (TIC)	2.9	REALLOCATED TO COST ITEMS, EXCESS PROFITS ELIMINATED	1.5
LOCAL SWITCHING	4.2	TELRIC	2.0
SUBTOTAL	7.1		3.7
OTHER COSTS			
TRANSPORT	1.1	AT COST	1.1
SPECIAL ACCESS	3.1	AT COST	3.1
INFORMATION	.3	AT COST	.3
MISC.	1.0	AT COST	1.0
SUBTOTAL	5.5		5.5
GRAND TOTAL	23.4		15.6

Source: Current level rates are from Access Charge Notice, Table 1. Reformed levels are explained in the text.

Driving costs to TELRIC and recognizing the loop as a common facility used to provide all services should result in a reduction in the subscriber line charge of over 50 percent. Similarly, driving local switching costs to the forward-looking, efficient levels should result in a reduction of those costs of over 50 percent.

III. LOOP COSTS

A. THE LOOP IS A COMMON FACILITY

One of the central tenets of telecommunications public policy is that the loop is a cost shared among all of the telecommunications services that utilize it: local and long distance, basic and enhanced, information, data, and video.[25] The courts recognized this principle almost three quarters of a century ago in the case *Smith v. Illinois*. Many of the states have formally recognized this principle in recent cost dockets.[26] The Congress recognized this in section 254 (k) of the

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[25] The Impact

[26] In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112.24 In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1.26 "Comments of the State of Maine Public Utility Commission, the State of Montana Public Service Commission, the State of Nebraska Public Service Commission, the State of New Hampshire Public Utilities Commission, the State of New Mexico State Corporation Commission, the State of Utah Public Service Commission, the State of Vermont Department of Public Service and Public Service Board, and the Public Service Commission of West Virginia" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 (hereafter Maine, et al.), p. 18; "Comments of the Idaho Public Service Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 (hereafter Idaho), p. 17); "Comments of the Public Utility Commission of Texas" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 (hereafter Texas), p. ii; "Initial Comments of the Pennsylvania Public Utility Commission to the Notice of Proposed Rulemaking and Order Establishing Joint Board" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45,

Telecommunications Act of 1996. The Commission has recognized this in its interconnection order as well as the access charge reform notice.[27] The Commission must treat loop costs in a principled manner that recognizes the fundamental nature of this shared facility.

First, all services that utilize the telecommunications network should pay for all facilities that they use in reasonable proportion to the nature of the demand that they place on it. This is a simple and sound economic principle.[28]

Second, the quantity and type of demands placed on facilities by services should be reflected in the costs that they are responsible for recovering. The more a service uses and the higher the level of functionality a service requires of a facility, the greater the responsibility it should bear for recovering its costs. The introduction of digital technology to the loop has dramatically increased the variable nature of the cost. The loop is no longer "the string between the tin cans." Increasingly, decisions regarding how much fiber to pull, how much to light, and where to put the electronics, vary with respect to the type and nature of services one plans to support with the loop. The Commission is to be commended for recognizing these variations in its Section 214 Video Service Cost Allocation docket.

April 12, 1996 (hereafter Pennsylvania), p. 7.; Florida, p. 22; "Initial Comments of the Virginia Corporation Commission," In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 (hereafter Virginia), p. 5; "Comments of the Staff of the Indiana Utility Regulatory Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 (hereafter Indiana), p. 9.

[27] Local Competition, para 678, Access Charge Notice, para. 237.

[28] Joint Statement, Joint Comments

Third, it is now clear that loop costs are falling dramatically.[29] At the time of divestiture it was argued that loop was the "ugly duckling" of the telecommunications industry, lagging behind in technological advancement and cost reduction. This argument was used to justify the allocation of productivity improvements to long distance and enhanced services. This argument was always debatable since, in a multi-product firm with vast shared, joint and common costs such as those in the telecommunications industry, the apparently superior productivity of some services reflects cost allocation decisions more than real cost causation. But regardless of whether that argument was ever valid, it is no longer true today. The introduction of digital technology to the loop has dramatically lowered the cost of providing loop and spread those costs over a much broader array of services. The Joint Board recognized this principle when it recommended that universal service support from the high cost fund take into account all revenues earned in an exchange.

B. THE SUBSCRIBER LINE CHARGE (SLC) SHOULD BE LOWERED

Since its establishment in the mid-1980s, the SLC has never been reduced to reflect the substantial decline in the cost of basic service that has occurred over this period. An analysis of the decline in loop costs since divestiture would suggest a reduction in the SLC on the order of 20 to 50 percent. On the contrary, some companies have suggested that the SLC should be indexed for inflation,[30]

[29] Current Issues
[30] Joint Reply Comments

but there is no justification for such a simple approach. Instead, any indexing should reflect a productivity offset.

Our organizations believe that the share of loop costs allocated to the federal jurisdiction should remain at 25 percent of the loop.[31] However, since loop costs should be calculated at TELRIC, the total amount recovered from the federal jurisdiction should be reduced. At present, the local exchange companies recover $3.50 per line/month in Subscriber Line Charges and the equivalent of approximately $2.50 per line/month in Carrier Common Line Charges for loop costs allocated to the federal jurisdiction. Based on the Commission's estimate of TELRIC loop costs in the local competition proceeding, we believe the combined amount should decline to approximately $3.60 per month.[32]

We recommend that the recovery of loop costs in the federal jurisdiction be split equally between subscribers and long distance service providers, as has been the Commission's long standing policy.[33] The SLC should be reduced to $1.80 on the basis of this reestimation of costs.

This recommendation on changes in the recovery of loop costs makes it clear that we reject the Commission's suggestion that the SLC for second residential lines should be raised.[34] The SLC is already above the forward looking cost of providing loop. Second lines are actually much less expensive to provide than first lines. In testimony before the Commission, one of the Regional Bell

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[31] The Impact

[32] We estimate the weighted average TELRIC of loop to be $14.35, based on Local Competition Order, Appendix D. One-quarter of $14.35 is $3.60.

[33] 59/50 citation

[34] Access Charge Notice, para. 65.

Operating Companies admitted that a second line costs only three-fifths as much as a first line. Some state consumer advocates suspect that the cost is considerably less than that. For purposes of argument, however, we can accept the three-fifths number. If the FCC is serious about moving prices toward costs, it should set the SLC for second lines lower, not higher, than the first line.

C. THE IXC SHARE OF LOOP COSTS MUST BE PRESERVED

The remainder of loop costs allocated to the federal jurisdiction are recovered through the carrier common line charge. The Commission should continue to require long distance service providers to pay for the use of the loop, since it is a common cost subject to section 254 (k) of the 1996 Act.

The Commission has expressed concern about the form in which these costs are recovered.[35] The current policy of recovering part of the interstate loop costs as a fixed charge (the SLC) and part as a variable charge (CCL) is a compromise to a thorny cost recovery problem. A usage-based charge may over-recover from some users because costs are not usage sensitive. At the same time, we have already noted that loop costs have become distinctly more variable as the demands of services for loop capacity and functionality have become more variable. It is also true that the revenue opportunity presented by the loop is dictated by usage -- i.e. when a long distance call occupies the line it is using the revenue opportunity the loop provides (the other party gets a busy signal). As a

[35] Access Charge Notice, para. 60.

result, we are not opposed to carefully transforming the CCL into a channel charge placed on the provider of the service, since the channel is what is being used.

IV. SWITCHING COSTS

A. SWITCHING COSTS SHOULD MOVE TO EFFICIENT LEVELS

Switching costs should also move toward forward looking efficient costs. This requires elimination of the Transport Interconnection Charge (TIC). To the extent possible, the TIC costs should be reallocated to the appropriate cost elements. To the extent that there are uneconomic costs embedded in the TIC, they should be eliminated. The Commission's suggestion that reductions in the rate of return (uneconomical excessive profits) be used to reduce the TIC is reasonable.[36]

Local switching costs should also move to forward looking costs. The Commission has clear evidence before it that these costs are in the range of $.002 to $.004 per minute.[37] This would lower the total cost recovered to approximately $2 billion.

B. THE COMMISSION SHOULD GUARANTEE PASS-THROUGH OF ALL ACCESS CHARGE REDUCTIONS

Any reduction in access charges should be passed through to basic long distance rates. The Commission should require that basic long distance service

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[36] Access Charge Order, para. 121.

[37] Local Competition Order, para. 811, establishes these costs in the range of $.002 to $.004 per minute.

rates be lowered to ensure that residential ratepayers receive the full benefit of these reductions. It is quite clear that competition in long distance markets is selective and targeted to specific market segments. In other market segments, the long distance companies engage in umbrella pricing. Most importantly, recent pricing activity by the long distance companies makes it clear that simply lowering their access costs does not and will not result in a pass-through to consumers.[38]

V. ADMINISTRATIVE SIMPLICITY AND ECONOMIC REALITY

A. THE FCC's INCLINATION TOWARD DEAVERAGING AND DECOMPOSING COSTS INTO VARIABLE AND FIXED COMPONENTS DOES NOT REFLECT MARKET REALITIES

The Commission repeatedly raises questions about the averaging[39] of costs and dissecting costs to distinguish variable and fixed costs.[40] We believe that it makes little sense to consider any averaging of costs to be a subsidy since it is

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[38] Industry Analysis Division, Trends in Telephone Service, May 1966, Table 5, shows four years of rising long distance rates. The increase on Thanksgiving Day ensures a fourth year of increases.

[39] The current common line rate structure, in which only a portion of common line costs are recovered through flat monthly rates, does not reflect the manner in which loops costs are incurred (Para. 58).

The circumstances under which we should grant LECs rate structure flexibility in their recovery of interstate common line costs from IXCs (Para. 62).

Should the commission permit or require ILECs to deaverage SLCs as part of the baseline rate structure that would be imposed on all incumbent price cap LECs. We seek comment on whether geographic averaging of SLCs is an implicit subsidy that is inconsistent with the requirements of section 254 (e), and thus on whether we are required to deaverage SLCs (Para. 67).

Does Section 254 (g) preclude an IXC from charging its customers the flat rate monthly rate assessed for a line if the amount varies among states, or between urban and rural areas within a state (Para. 63).

[40] Fixed costs of local switching (Para. 72). Call set up (Para. 75).